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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Accounting for Judgments and Other Costs Associated with Litigation	)))	CC Docket No. 93-240

COMMENTS OF U S WEST COMMUNICATIONS, INC.

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October 15, 1993

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SUMMARY

In this proceeding the Commission proposes to readopt the old rules concerning accounting for litigation expenses which had been vacated by an appellate court. The critical aspect of these rules is that the Commission would, under the proposed rules, judge the reasonableness of incurred litigation expenses based on whether a particular piece of litigation was won or lost. The Commission proposes to apply these rules to lawsuits involving federal or state antitrust statutes and, possibly, to an unenumerated set of other federal statutes.

The Commission should decline to adopt the proposed rules. It is judicially bound to accept the premise that litigation costs are a normal part of doing business in today's world, and declaring such costs to be unreasonable based on the outcome of a suit would not be lawful. In addition, there is no reason to adopt the rules. Attempting to control carrier conduct through accounting classifications is grossly inefficient -- an inefficiency dramatized by the Commission's proposals to prohibit current accounting for litigation expenses during a trial, and to require a massive showing as a prerequisite to proper accounting for even some of the costs of a prejudgment settlement. The proposal also violates sound accounting principles and good ratemaking techniques. Moreover, the plan to struggle with all other federal statutes to determine which of these laws will likewise invoke the proposed new rules is likewise an invitation to nightmare -- to no good purpose.

In short, the proposed new accounting rules should be abandoned in their entirety.

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COMMENTS OF U S WEST COMMUNICATIONS, INC.

U S WEST Communications, Inc. ("USWC"), through counsel, hereby submits the following comments on the Notice of Proposed Rulemaking and Order ("NPRM") in the above-captioned docket.[1]

In the NPRM, the Federal Communications Commission ("Commission" or "FCC"), in the teeth of an express Court decision to the contrary,[2] in essence proposes to readopt the rules concerning accounting treatment of litigation costs vacated by the Court of Appeals for the District of Columbia Circuit in Mountain States Tel. & Tel. Co. v. FCC.[3] Specifically, the Commission proposes to require that all litigation expenses incurred in an unsuccessful defense of an antitrust suit (federal or state) be recorded in below-the-line accounts, subject to presumptive disallowance for ratemaking purposes. Prejudgment

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[1] See In the Matter of Accounting for Judgments and Other Costs Associated with Litigation, CC Docket No. 93-240, Notice of Proposed Rulemaking and Order, FCC 93-424, rel. Sep. 9, 1993 ("NPRM").

[2] Mountain States Tel. and Tel. Co. v. FCC, 939 F.2d 1021 (D.C. Cir. 1991), reh'g denied, Order, Nos. 88-1262 and 89-1421 (D.C. Cir. Oct. 22, 1991) ("Mountain States I").

[3] 939 F.2d 1035 (D.C. Cir. 1991), reh'g denied, Order, Nos. 89-1421 and 88-1262 (D.C. Cir. Oct. 22, 1991) ("Mountain States II").

antitrust settlements may be booked in above-the-line accounts only to the extent that the carrier can prove that such an amount would have been incurred as a legal expense had the case been litigated to a successful conclusion. Postjudgment settlements, and all adverse judgments, are to be booked below-the-line. Current litigation expenses associated with antitrust litigation are to be booked in holding accounts subject to ratemaking treatment (or nontreatment) at some future date, depending upon the outcome of the case. All antitrust judgments and settlements incurred between now and the resolution of this proceeding are also to be booked in deferred accounts subject to future ratemaking treatment. For the reasons stated below, we oppose adoption of the proposed rules.

I. THE COMMISSION MAY NOT IGNORE THE COURT'S DECISION REGARDING THE LITTON ANTITRUST EXPENSES

The rules proposed herein have already been adopted once -- and vacated on appeal. The critical foundation for this NPRM is the Commission's assumption that the earlier vacated litigation cost rules had been basically affirmed rather than vacated by the D.C. Court of Appeals in Mountain States II.[4] Throughout the entire NPRM, the Commission consistently makes reference to the Court in Mountain States II accepting, agreeing with, and affirming the old litigation expense rules.[5] The Mountain

[4] See Mountain States II, 939 F.2d at 1035.

[5] NPRM at ¶¶ 6, 11.

States I decision is treated almost entirely as an advisory opinion which the Commission states it is free to ignore.[6] Thus, the Commission feels that it is entirely free to simply readopt the old vacated rules so long as it fixes a few procedural foibles which, in the Commission's mind, were the sole barrier between the old rules and legality. And the Commission in the NPRM proposes to do so.

In reaching this basic conclusion, the Commission in the NPRM is forced to engage in a little creative history. In Mountain States I, the Court reviewed a specific ruling on the accounting treatment of litigation expenses arising out of the Litton antitrust case.[7] The Commission's treatment of these litigation expenses was expressly and specifically reversed by the D.C. Circuit Court of Appeals on the basis of the precise line of legal analysis which the Commission now states in the NPRM it is free to ignore.[8] The language in Mountain States II which the Commission finds so attractive, on the other hand, consists of comments on FCC rules by a Court which, after making the comments, proceeded to vacate those rules in their entirety. The Court's comments had nothing whatsoever to do with the decision in Mountain States II. The language in Mountain States II upon which the Commission seems determined to predicate its entire authority to act in the NPRM is simply dicta by the

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[6]Id. at ¶ 29.

[7]See Mountain States I, 939 F.2d at 1023-26.

[8]See id. at 1029-34.

reviewing Court. The language which the Commission seeks to avoid in Mountain States I, however, represents the law of the case and is binding on this Commission.

The Commission has it backward. The case which it is bound as a matter of law to follow is Mountain States I, in which the precise holding of the case was that the Commission's approach to litigation expenses violated its lawful authority under the Communications Act. This holding in Mountain States I is binding upon both the D.C. Circuit and upon the Commission. The dicta in Mountain States II, while representing the thoughtful opinions of one of the distinguished jurists on the D.C. Court of Appeals, is simply not the law of the case, either in the D.C. Circuit or before the Commission. The Commission is bound to follow the law and language of Mountain States I in determining whether to implement new accounting rules for litigation expenses, and, if so, what they should say.[9]

II. THE LAW OF MOUNTAIN STATES I

Once it is properly recognized that the Mountain States I decision must govern the Commission's proceeding, it becomes apparent that there is no good reason for opening this docket. Antitrust judgments have always been subject to scrutiny by the Commission, and this rulemaking is extraneous as to such

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[9]It is universally accepted that "[b]inding circuit law comes only from the holdings of a prior panel, not from its dicta." Gersman v. Group Health Ass'n, Inc., 975 F.2d 886, 897 (D.C. Cir. 1992) (underscoring added), pet. for cert. filed, 61 USLW 3523 (Jan. 13, 1993) (No. 92-1190).

judgments. On the other hand, legal expenses, including expenses incurred in defending lawsuits, are normal business expenses. To deny a carrier the right to defend itself in a lawsuit because it cannot predict certain victory in advance is both unlawful and silly. To try to control carrier conduct through accounting treatment of its legal expenses is even worse. The Commission should simply heed the words of the Court in Mountain States I and terminate this proceeding. In Mountain States I, the Court summarized our basic position as follows:

> Perhaps the most puzzling aspect of the Commission's policy is just how regulatees can abide by it and still operate efficiently. It has long been the conventional rule that utility expenses prudently incurred are allowable in ratemaking. 'Good faith is to be presumed on the part of the managers of a business,' the Supreme Court has declared, and '[i]n the absence of a showing of inefficiency or improvidence, a Court will not substitute its judgment for theirs as to the measure of a prudent outlay.' We agree that 'lawsuits are a recurring fact of life in operating a business' -- and in that even the Commission concurs -- and litigation strategies undoubtedly are a recurring if indeed not a constant business challenge. Antitrust suits frequently present a multitude of complex issues, many of which may be intertwined with esoteric economic concepts in a legal context where precedents and clear standards may be hard to come by. Serious strategy planning may at best be difficult, and under the Commission's regimen may be well-nigh impossible. Planning for any given antitrust case must be done in total ignorance of the factor the Commission deems critical -- the final outcome of the case -- and in the ominous shadow of the looming adverse presumption. Petitioners hardly exaggerate when they declare that no one could possibly predict that defense of a lawsuit as difficult as Litton would be ultimately successful. We believe the tension between long-standing judicial and

> newly devised administrative procedures could hardly be more severe.[10]

What the Commission does in the NPRM is exactly what resulted in its reversal in Mountain States I. The Commission compares losing a civil lawsuit to a kind of a character defect, assumes that violating the antitrust laws can never benefit ratepayers,[11] and further assumes that accounting rules which discourage defense of such lawsuits will somehow benefit ratepayers. Thus, the Commission, once again, proposes to utilize its accounting processes as a manner of regulating carrier conduct, presumably in an effort to reduce the number of antitrust violations committed by carriers.

In an accounting docket, the key to accounting treatment ought to be reasonable and prudent, not the morality of the carrier. Defending a lawsuit clearly is done in the normal course of business, and failure to defend a lawsuit would in many instances be tantamount to a failure on the part of management to properly carry out its own fiduciary responsibilities of the corporation. There is simply no sound reason to act otherwise.[12]

On the other hand, if one assumes the basic accuracy of the assumptions in the NPRM, the results become even more bizarre.

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[10]Mountain States I, 939 F.2d at 1034 (footnotes and citations omitted).

[11]NPRM at ¶ 9.

[12]See Mountain States I, 939 F.2d at 1031-33.

Operating on the assumption that corporate executives generally act in the best interests of the corporations they manage, establishing a presumption that conduct which violates the antitrust laws does not benefit ratepayers is in itself a strange and insupportable notion. For example, in the Litton case, it is hard to imagine that American Telephone and Telegraph Company's ("AT&T") management did not firmly believe that AT&T's conduct vis-a-vis Litton was firmly designed to provide the maximum benefit to AT&T's shareholders and the totality of AT&T's ratepayers. Obviously, a court found that the conduct was unlawful, and that Litton suffered damage thereby. It is also probably presumptively true that the AT&T shareholders and ratepayers did not benefit by payment of the Litton antitrust judgment. However, there is absolutely no evidence to demonstrate that the conduct challenged by Litton, or any other antitrust suit for that matter, did not increase AT&T's profits and reduce AT&T's overall interstate telecommunications rates -- thus benefitting both AT&T's shareholders and AT&T's ratepayers.

This is not to say that we advocate antitrust misconduct, or that the public interest itself was furthered by any antitrust violations found against AT&T. But to say this is quite a different matter than to find that ratepayers as a class were disadvantaged by AT&T's conduct which led up to the Litton litigation, or that ratepayers were disadvantaged by defense of the Litton lawsuit. If corporate executives are deliberately acting contrary to the best interests of shareholders or

ratepayers, or are flaunting the antitrust laws, a far more serious situation exists than can be remedied with a little below-the-line accounting. Our point, however, is very simple. The costs of litigation are a normal expense of doing business, and a company's ability to defend itself in litigation, particularly major litigation, cannot lawfully be compromised by the Commission by requiring a company to prejudge the outcome of any case that it is defending. That is the law of Mountain States I, and it ought to be the firm guiding law behind any effort that deals with litigation expenses in this proceeding.

III. PREJUDGMENT SETTLEMENTS OUGHT TO BE RECORDED IN ABOVE-THE-LINE ACCOUNTS IN THEIR ENTIRETY

Another proposal made in the NPRM is that prejudgment settlements of antitrust cases be booked in above-the-line accounts only to the extent permitted by the Commission upon a showing that so much of the settlement represented the "nuisance value" which would have been expended to successfully defend the suit in the absence of a settlement.[13] The Commission's theory here is that a settlement prior to judgment is at least quasi-concessionary of antitrust misconduct, and, in order to discourage the misconduct in the first place, only limited amounts of settlement expenses are to be booked above-the-line. Consistent with the foregoing analysis concerning litigation expenses in Section II above, we believe that antitrust

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[13]NPRM at ¶¶ 12-14.

settlements, at least if incurred prior to judgment, ought to be booked as normal litigation expenses, above-the-line in all instances. However, there is an additional reason for reaching this conclusion in regard to such settlements. The Commission actually has experience with one such settlement, and the administrative quagmire which resulted when a carrier tried to make the showing demanded by the Commission in its proposed rules is excellent testimony to the effect that the rules as proposed do not work.[14] We submit that the Alascom proceeding demonstrates quite clearly that whatever benefit ratepayers might receive from the proposed treatment of settlement expenses when antitrust cases are settled before judgment, such benefits are clearly not worth the massive administrative headache caused by the procedures necessary to comply with such accounting treatment.

IV. THE COMMISSION'S PROPOSAL TO HOLD CURRENT LITIGATION EXPENSES IN HOLDING ACCOUNTS PENDING RESOLUTION OF LAWSUITS IS INCONSISTENT WITH SOUND ACCOUNTING PRACTICES

The basic unwisdom of treating litigation expenses for accounting purposes based upon the ultimate outcome of the lawsuit is demonstrated by the way in which the NPRM proposes to treat litigation expenses incurred during the course of a lawsuit. The Commission proposes to require that antitrust

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[14] See In the Matter of Alascom, Inc., Request for Rulemaking Regulation of an Antitrust Settlement, Memorandum Opinion and Order, 5 FCC Rcd. 654 (1990); Memorandum Opinion and Order, 6 FCC Rcd. 3636 (1991) ("Alascom").

litigation expenses be accrued in a balance sheet deferral account until the case is resolved. Thereafter, under the Commission's proposal, the expenses could receive appropriate above-the-line recognition should the case be won (via amortization over future periods). Upon unfavorable resolution, the expenses would be charged to below-the-line Account 7370. The Commission concludes that this proposed treatment is "fair and equitable," and that it manages to avoid violation of the rule against retroactive ratemaking.[15] The Commission's efforts to treat these clearly current costs as future costs for ratemaking purposes is simply bad accounting, even if the underlying effort to base the prudence of litigation costs upon the outcome of the case were otherwise lawful and nonarbitrary.

The proper treatment of litigation costs as current expense items, rather than future expense items, is well stated in the Financial Accounting Standards Board Statement of Concepts No. 6, which observes:

> Services provided by other entities, including personal services, cannot be stored and are received and used simultaneously. They can be assets of an entity only momentarily -- as the entity receives and uses them -- although their use may create or add value to other assets of the entity.[16]

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[15]NPRM at ¶¶ 17, 18. The rule against retroactive ratemaking precludes a regulator or a carrier from setting future rates to make up for past over or underearnings. See, e.g., Nader v. FCC, 520 F.2d 182, 202 (D.C. Cir 1975); Southern California Edison Co. v. FERC, 805 F.2d 1068, 1070 n.2 (D.C. Cir. 1986).

[16]Financial Accounting Standards Board Statement of Concepts No. 6, "Elements of Financial Statements," at ¶ 31.

Generally Accepted Accounting Principles ("GAAP") require immediate recognition of legal costs because legal services are being rendered (used up) and there is no basis for treating them as an asset or other future benefit. The only reason for not flowing current legal expenses through current expense accounts -- that this Commission might decide to disallow them at some future period for ratemaking purpose -- combines bad accounting with bad ratemaking. Given the Commission's on-the-record desire to bring its own accounting rules closer to GAAP,[17] the notion of treating current litigation costs as future costs simply makes no sense at all.

V. OTHER LAWSUITS

As another point, the Commission questions whether other types of civil actions should give rise to the accounting treatment which it desires to make applicable to antitrust litigation costs. The Commission proposes to limit this treatment to "lawsuits involving violation of federal statutes in which the actions giving rise to the suit did not benefit ratepayers."[18] The Commission then requests comments on alternate proposals to determine which federal statutes fall into this category on a case-by-case basis, or developing, by

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[17]See Responsible Accounting Office: Re: Uniform Accounting for Postemployment Benefits in Part 32, RAO Letter 22, 8 FCC Rcd. 4111 (1993). Also see, Letter to Mr. G. Michael Crumling, Director-Federal Relations, 8 FCC Rcd. 2961 (1993).

[18]NPRM at ¶ 22.

rulemaking, a list of such statutes.[19] Various accounting proposals, including deferral accounting, etc., are likewise proposed.

Given that we live in a society where almost 300 volumes of the Federal Reporter have been published in the last decade alone, we think that only one thing is undeniably certain about this aspect of the Commission's proposal: implementation of any permutation of the Commission's proposal in this regard would cost ratepayers and taxpayers exponentially more in costs than any amount ratepayers might save through reduced rates. At least in the case of antitrust laws, there is some special nexus between the Commission and enforcement of the antitrust laws. In the case of all other federal statutes, this nexus is simply not to be found at all. Other than a theoretically pure vision of what ratepayers ought to finance in terms of their rate payments, we can see absolutely no good reason why the Commission should even be considering taking this action.

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[19] Id. at ¶¶ 24-25.

VI. CONCLUSION

Accordingly, we request that this proceeding be terminated without adoption of any of the rules proposed in the NPRM.

Respectfully submitted,

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By: _____

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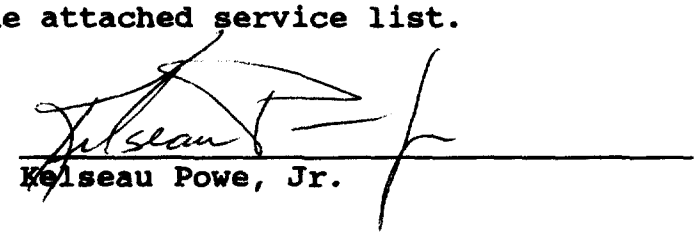
October 15, 1993

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 15th day of October, 1993, I have caused a copy of the foregoing **COMMENTS OF U S WEST COMMUNICATIONS, INC.** to be hand delivered, upon the persons listed on the attached service list.



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